Why farmland now?

Amidst unprecedented market volatility, Westchester Group Investment Management, an investment specialist of Nuveen, explains why they believe farmland is a durable and consistent investment.

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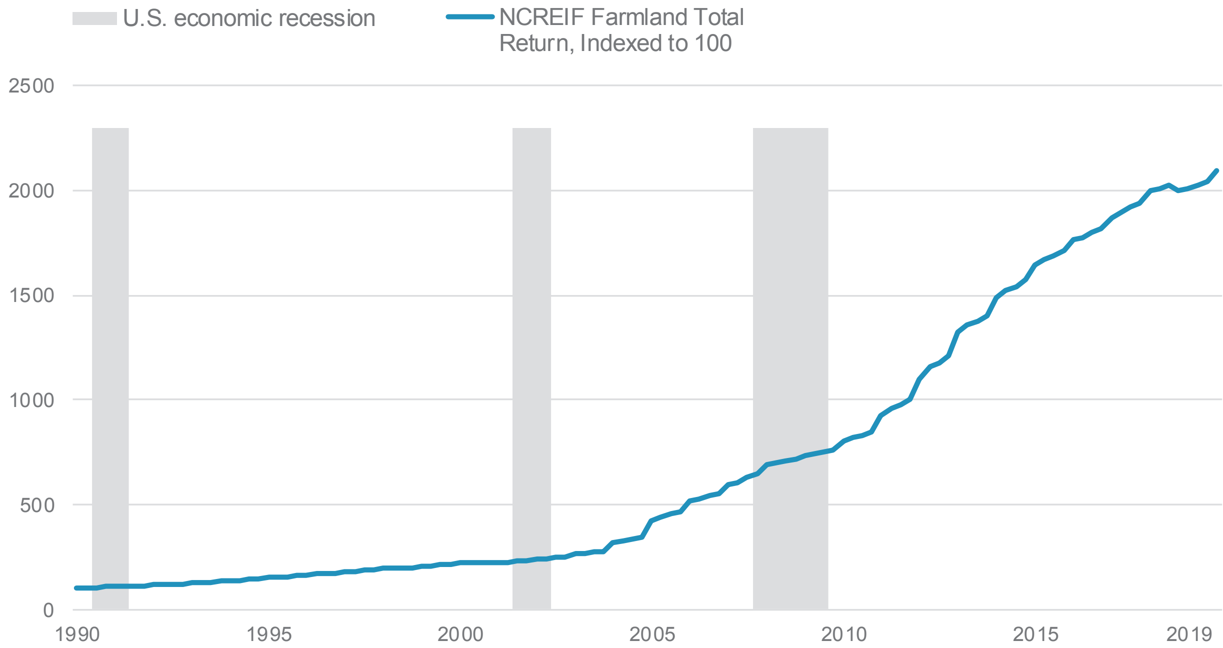
Figure 1: Resilience to the economic cycle



Source: Macrobond, National Council of Real Estate Investment Fiduciaries (NCREIF) Farmland Index, data to 31 Dec 2019.

Financial markets are responding to the current limited visibility and uncertainty, both severely exacerbated by the coronavirus pandemic, by retreating towards safe haven investments such as U.S. treasuries (where yields have declined below 1%), gold and certain currencies (e.g. the U.S. dollar). Even prior to coronavirus, farmland investment provided a compelling alternative to traditional asset classes. Farmland has a history of preserving capital in times of economic downturns, and is currently delivering annual income returns above government bond yields in developed countries.

During the 2008 financial crisis — the most comparable contemporary proxy to the current crisis — negative consequences were experienced across most sectors of the U.S. economy. However, this period was relatively profitable for the agricultural sector, resulting in strong farm-gate profitability and higher agricultural land values. Kuethe et al. demonstrated that in the four-year period leading up to the 2008 financial crisis and the four-year period after the crisis, farmland consistently produced positive returns, outperforming U.S. treasuries, the Dow Jones, and the S&P 500 over the eight-year period[1].

When relative return volatility is considered in addition to expected returns, the case for farmland becomes even more compelling. U.S. farmland returns have experienced a similar level of volatility to U.S. 10-year bonds and significantly lower volatility than equities. Despite its comparable return volatility, farmland has consistently outperformed 10-year bonds, delivering significantly higher yields.

As a result of its superior risk-weighted return, farmland can be viewed as a powerful diversifier within an investment portfolio. Farmland's low volatility becomes particularly valuable in periods of financial uncertainty, such as now. Figure 1 demonstrates the strength of farmland returns over four decades despite periods when the U.S. and/or global economy was in recession.

U.S. farmland has delivered only one quarter of negative returns since 1999 (-0.01% in the first quarter of 2002). Importantly, during periods in which the S&P 500 declined, farmland delivered positive returns. The durability and negative correlation of farmland returns to economic cycles is driven by the necessity of food, which is supplied by a limited land resource base for survival of a growing population.

With the spread of coronavirus, there are concerns that food security could be jeopardised; however, there is no current evidence to validate this concern. During other pandemics, including SARS, the avian influenza and MERS, food prices rose. Coronavirus is not yet causing food shortages or significant price hikes.

Conversely, there are also concerns that land values could be damaged by the current crisis. Westchester does not anticipate that coronavirus will negatively impact short-term farmland values. If supply chain disruptions cause dislocations in commodity prices (e.g. commodity prices fall), the ultimate impact on land values will depend on whether the market views the dislocation as temporary or protracted. If viewed as temporary, farmland markets would not price in lower commodity prices; if longer term, lower commodity prices could be reflected in farmland values (all else equal). However, the negative impact on farmland values would likely be offset by lower interest rates, with central banks around the world strongly considering or actively implementing monetary stimulus measures.

Independent of the benefits farmland offers to portfolios in light of the impacts of coronavirus, it is a compelling time to invest in agriculture due to expected imminent productivity gains as new technologies come to market and the strong associated influence of productivity on farmland returns.

Over the last century, the introduction of key agricultural technologies and the resultant adoption rates successively increased their impact on Total Factor Productivity (TFP), which measures changes in the efficiency by which inputs are transformed into outputs. For example, TFP doubled in the 1990s to just over 1.5% per annum, following the introduction and adoption of herbicide tolerant corn, relative to what was achieved in the 1970s and 1980s.

The durability and consistency of farmland returns is unparalleled across other investment alternatives. Fundamental return characteristics remain intact, with upside potential on the horizon in the form of productivity advancements. Farmland possesses a number of unique characteristics, including strong yields, low volatility, negative correlation to equities, and a resilience to economic cycles. These factors create a compelling case for the inclusion of the asset class in a diversified investment portfolio.

FOOTNOTES:

1 Kuethe T.H. et al. (2013): Farmland versus Alternative Investments before and after the 2008 Financial Crisis. Journal of the ASFMRA p.120-131.

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